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The Federal Reserve's Main Street Lending Program

In response to Coronavirus Disease 2019 (COVID-19), the Federal Reserve (Fed) created a series of emergency lending programs, including the Main Street Lending Program (MSLP). The MSLP supports lending to eligible businesses and nonprofits and marks the first time the Fed has lent to nonfinancial businesses since the 1930s (though it purchased commercial paper [short-term debt securities] issued by nonfinancial businesses in 2008 and 2009).

COVID-19 and Main Street Businesses

Due to the effects of COVID-19, the U.S. economy has experienced a sudden and deep recession. The unemployment rate has reached its highest level since the Great Depression, and the decline in output in the second quarter of 2020 was record-breaking. Normal commerce was severely disrupted starting in March and has only partially recovered in the following months. Social distancing and fears of the virus hit many "main street businesses" in retail and hospitality industries particularly hard. Many disrupted businesses, even if solvent prior to COVID-19, began to experience cash flow problems and faced difficult decisions about how to stay in business.

One of the unique and problematic characteristics of the current recession is that it is driven by a public health crisis. When the public health crisis passes, surviving businesses may be able to fully reopen, but when that might occur is highly uncertain. It is therefore risky for a private lender to provide a loan to a "main street business," as it is uncertain if and when that business would be able to pay the loan back. Meanwhile, cash-strapped businesses need funds quickly to remain in business and retain employees. In addition, many businesses may need to defer payments on existing loans. Business closures would worsen an already historically high unemployment situation. For these reasons, policymakers have implemented programs to help struggling businesses and maintain employment levels. The MSLP is one such program intended to meet the needs of businesses of a certain size.

Main Street Lending Program

Under the MSLP, the Fed purchases loans with certain characteristics that depository institutions, such as banks, have made to businesses and nonprofits. The MSLP is targeted to "mid-sized" U.S. firms that were too large to be eligible for the CARES Act's (P.L. 116-136) Paycheck Protection Program (PPP) but too small to issue bonds or commercial paper, which the Fed is purchasing through other emergency programs. Although firms that do not fit this description can also be eligible, it was perceived that there was a gap in relief that the MSLP could fill. In addition, there was little federal relief for nonprofits too large for the PPP until the MSLP was expanded. The MSLP and PPP are comparable in some ways, and some businesses are eligible for both programs. However, there are differences in eligibility requirements, interest rates, and loan terms, among others (see **Table 1**).

Table 1. MSLP and PPP Comparison

	MSLP	PPP
Business/ Nonprofit Size Limits	15,000 or fewer employees, or 2019 revenues of $5 billion or less For nonprofits: minimum 10 employees	500 or fewer employees, or net worth is $15 million or less and average net income for past two fiscal years is $5 million or less
Interest Rate	LIBOR + 3%	1%
Loan Term	5 years	Prior to June 5: 2 years; after June 5: 5 years
Loan Size	$250,000 - $300 million	Up to $10 million or 2.5 times average monthly payroll
Payment Deferral/ Forgiveness	Principal deferred for two years, interest deferred for one year; not forgivable	6 month deferral and loans will be forgiven if all employee retention and other criteria are met
Amount Outstanding	$240 million (as of 8/10)	$525 billion (as of 8/8)
Application Deadline	December 31, 2020	August 8, 2020

Sources: Federal Reserve and the U.S. Small Business Administration
Notes: For brevity, the table omits some eligibility criteria.

As shown in **Table 1**, some of the main features of MSLP loans are eligibility based on firm size and deferment of principal and interest payments. The MSLP operates five facilities based on whether the loan is new or refinanced, whether the borrower is a business or nonprofit, and based on how indebted the borrower is. Each facility has different loan terms (such as maximum loan size, which varies from $35 million to $300 million). There is no minimum business size. However, there are minimum loan sizes, which, depending on the facility, are between $250,000 and $10 million. (To date, most loans have been over $1 million.) This may in effect exclude the smallest firms from participating because there are also limits on how indebted borrowers may be (called a leverage requirement). Certain businesses are ineligible if they are in industries that do not meet Small Business Administration eligibility criteria, such as financial and gambling businesses. Borrowers participating in certain other emergency relief programs are also ineligible, but PPP participants are eligible. Borrowers established since the pandemic or expecting to file for bankruptcy are also ineligible. A Goldman Sachs newsletter from July estimated that 40% of all private workers work for eligible companies.

Main Street loans cannot be used to pay off private debt because they are meant to be used to maintain payroll. MSLP borrowers must make "commercially reasonable efforts to maintain its payroll and retain its employees." This is not a legally binding requirement, and the Fed and Treasury stated to the Congressional Oversight Commission that they are not verifying that firms maintain payroll after receiving the loan.

The Fed purchases 95% of the loans; the lender must retain the remaining 5%. Profits or losses accrue proportionately to holdings. This gives lenders an incentive to perform sound underwriting when making loans. Purchasing 95% of the loans frees up space on the lender's balance sheet to make additional loans. Lenders may also charge fees to borrowers. By purchasing private loans instead of making loans directly, the Fed avoided the need to develop loan underwriting expertise before rolling out the program.

The Fed created the MSLP under its emergency authority 12 U.S.C. 343, which has several requirements. Programs must be temporary and approved by the Treasury Secretary. The interest rate must be above normal market rates; however, the MSLP's interest rate is comparable to the prime rate (a market rate that banks offer to their best customers). Actions must also provide security (e.g., collateral) that is sufficient to protect the taxpayer and is based on sound risk management practices.

To absorb potential losses, Treasury has pledged $75 billion in CARES Act funding—protecting the Fed but still exposing taxpayers to potential future losses. Likewise, potential profits from the facility ultimately accrue to taxpayers. A number of CARES Act conditions apply to the borrowers (but not the lenders), including restrictions on executive compensation, stock buybacks, and dividends. Both borrowers and lenders cannot have ownership relationships with certain elected and public officials. In addition, the CARES Act does not permit debt forgiveness.

The MSLP was announced as a $600 billion program, although the Fed's other facilities have proven to be much smaller or larger than their originally announced size. The program took several weeks to create because of the complexity and novelty involved and was not fully operational for business loans until July 6. As of August 10, the MSLP had finalized 32 loan participations worth $240 million, although the Boston Fed President testified that additional loan purchases were in process.

Policy Issues

Various stakeholders and policymakers have criticized the MSLP as too small to be effective. There are three broad possibilities why: (1) it is still too new and may eventually grow to the desired size; (2) it is not attractive to lenders; or (3) too few borrowers qualify or find it attractive.

The second or third problem could be addressed by changing the program's terms. However, because MSLP is set up to share profits and risks between the Fed and lenders, any changes to terms that are more favorable to the borrower or lender will make the other party or the Fed (or both) worse off. For example, a lower interest rate or laxer eligibility terms may entice more borrowers to participate but would reduce expected profits (or increase expected losses) for lenders and the Fed. Conversely, a higher interest rate or shorter deferment period would make the program more attractive to lenders but less attractive to borrowers. Given the zero sum nature of these changes, one would need to know whether the program was unattractive to lenders or borrowers in order to make changes that successfully stimulated activity; the current absence of lending is consistent with either scenario. (As of August 4, 509 banks, with 58% of industry assets, had registered with the MSLP. That does not mean that all are making Main Street loans, especially to new customers.)

Alternatively, the Fed could subsidize lending in a way that would make it more attractive to lenders and borrowers, but such a subsidy would raise the expected cost to the Fed (and taxpayers). Subsidized lending might be difficult given statutory restrictions. Some have argued that Congress did not intend for CARES Act funding to the Fed to be repaid, but particular provisions of the act seem to contradict this view. The Fed has made several modifications to the MSLP to make it more attractive to borrowers and lenders.

One factor limiting the MSLP's size is that it was designed to address one specific problem, whereas businesses currently face diverse credit problems. The Boston Fed president testified that the MSLP "was designed to provide credit support for business or nonprofit borrowers that have temporary cash-flow problems due to the pandemic—and given the uncertain outlook might otherwise have difficulty in obtaining credit from a lender.... Main Street can provide a loan to bridge the borrower over this current challenge."

The MSLP was not designed to help businesses facing permanent declines in demand for their products or, conversely, businesses wanting credit that are experiencing robust demand—ideally, the latter could find credit in private markets. Policymakers may consider creating alternative relief programs for borrowers (e.g., highly indebted companies, startups, or hard-hit industries) that do not fit well with the MSLP's purpose.

Policymakers may also consider whether the program adequately addresses the policy goal of employee retention, although a stronger retention requirement would likely make the program less attractive to borrowers.

CRS Resources

CRS Report R46411, *The Federal Reserve's Response to COVID-19: Policy Issues*, by Marc Labonte.

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